

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Klehs Analyst: Anne Mazur Bill Number: AB 1615  
Related Bills: See Legislative History Telephone: 845-5404 Introduced Date: February 22, 2005  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Abolish Franchise Tax Board/Transfer Duties To Board Of Equalization

### SUMMARY

This bill would abolish the Franchise Tax Board (FTB) and transfer its powers and duties to the State Board of Equalization (BOE).

This bill would also transfer to BOE the tax administration functions of the Employment Development Department (EDD) and Department of Insurance (DOI). These provisions are not addressed because they do not impact the department.

### PURPOSE OF THE BILL

According to the author's staff and legislative intent recited in the bill, the purpose is to provide a governmental organization that will ensure centralized, effective, efficient, and impartial tax revenue collection, administration, and enforcement.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2006. The bill provides that the sections regarding FTB's consolidation with BOE would be operative January 1, 2007.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

The IRS collects and administers the federal income tax and various other taxes, including employment taxes. Taxpayers may petition the Tax Court to redetermine deficiency assessments proposed by the IRS. This redetermination is a trial de novo (new). Either party may appeal an adverse Tax Court determination to the federal appellate courts.

In lieu of petitioning the Tax Court to redetermine a deficiency, the taxpayer may pay the tax and file a claim for refund with the IRS. Assuming the IRS denies the claim for refund, the taxpayer may bring a lawsuit in federal district court or the U.S. Court of Federal Claims for the recovery of the amount paid. Either party may appeal an adverse court determination to the federal appellate courts.

Board Position:

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_____ N	_____ OUA	_____ PENDING

Department Director

Date

Under California law, three agencies are involved in the administration of the income tax laws:

- EDD's Tax Branch administers the collection, accounting, and auditing functions of California's payroll tax program. The program consists of Unemployment Insurance and Employment Training Tax, which are employer contributions, and Disability Insurance and Personal Income Tax, which are withheld from employees' wages.
- FTB administers the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL). FTB collects taxes under the PITL and CTL through withholding from sources other than wages, payment of estimated income taxes, and other remittances such as return payments. If necessary, FTB also collects balances due by recording property liens or issuing withholding orders on earnings or bank accounts. FTB also administers non-income tax related programs including: Senior Citizens Homeowners and Renters Property Tax Assistance program (HRA); non-tax debt collection programs, including child support (ending July 1, 2005), court-ordered debt, vehicle registration, industrial health and safety, and interagency intercepts; Political Reform Audit (PRA); and the Nonadmitted Insurance Tax program (NIT). FTB is also responsible for developing and implementing the California Child Support Automation System (CCSAS), which is budgeted at more than \$1 billion over a ten-year period. Upon full implementation of CCSAS, scheduled for 2008, the state will be relieved of annual federal penalties of more than \$200 million. The three-member FTB is comprised of the State Controller, Director of Finance, and Chair of the BOE.
- BOE is a constitutional body that is an agency-equivalent not reporting to the Governor. BOE administers property tax, sales and use tax, and special taxes including fuel tax, excise tax, environmental fees, and electronic waste recycling fee. The five-member BOE includes the State Controller and four elected members.<sup>1</sup> The BOE is vested with the authority under the Sales and Use Tax Law to "redetermine," that is, administratively review, determinations made by the BOE with respect to tax programs it administers. In addition, the BOE is authorized to decide taxpayer appeals of FTB actions on personal income tax, franchise tax, and HRA matters.

### THIS BILL

This bill would abolish FTB as of January 1, 2007, and provide that as of that date:

- All the duties, powers, purposes, responsibilities, and jurisdiction of FTB would be transferred to BOE.
- Any legal action to which FTB is a party would continue in the name of BOE and the substitution of BOE would not affect the rights of the parties to the action.
- The executive officer of BOE would organize the new responsibilities in any manner deemed necessary for the proper conduct of the BOE's consolidated revenue collection, administration, and enforcement functions.
- FTB civil service staff would be transferred to BOE in accordance with current laws regarding civil service employees.
- All contracts, leases, licenses, or any other agreements to which BOE or FTB is a party would remain in full force and effect with BOE assuming all of the rights, obligations, and duties of FTB, and the substitution of BOE would not affect the rights of the parties.
- The unspent balance of FTB's budget would be transferred to BOE for the support and maintenance of BOE.
- All books, documents, records, and property of FTB would be transferred to BOE.

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<sup>1</sup> For this purpose, the state is divided into four districts. One member is elected from each district.

By June 30, 2006, BOE would be required to submit a report to the Governor and the Legislature regarding the plan for, and the progress of, the assumption of FTB's duties. The report would include recommendations for legislation necessary to more effectively achieve the efficiencies and purposes intended by this bill. According to the bill, these recommendations would include, but not be limited to the following:

- A strategic plan regarding the assumption of FTB's duties, including the identification of critical issues such as the consolidation of computer systems, telecommunications, and office space.
- Identification of functions that would be conducive to consolidation or centralization such as administrative functions, document processing, remittance cashiering, public service, collection, and physical equipment and facilities.
- Identification of administrative functions that cannot be readily consolidated due to statutory conflicts or inconsistent administrative processes.

This bill states legislative intent to provide a government organization that ensures centralized, effective, efficient, and impartial tax revenue collection, administration, and enforcement. In addition, the bill states intent to streamline the functions previously performed by both FTB and BOE and that this consolidation should occur 1) in the least disruptive manner so that tax collections are not adversely affected, and 2) as expeditiously as is feasible and economical.

#### IMPLEMENTATION CONSIDERATIONS

This bill would authorize the consolidation of four revenue-generating organizations. The successor entity would have approximately 10,000 employees and an annual budget of approximately \$1 billion. The following table shows staff positions and funding based on the Governor's 2005/2006 proposed budget.

	Positions	Funding, in millions
BOE	3,628.0	\$364.9
FTB	5,285.0	699.6 <sup>2</sup>
EDD	1,787.0	177.0 <sup>3</sup>
DOI	18.1	2.1

Until implementation plans and identification of problems are clarified, the impact of transfer of duties is unknown. Department staff notes the following concerns:

This bill would require BOE to report by June 30, 2006, on the plan and progress of BOE's assumption of FTB's, EDD's, and DOI's duties to be accomplished as of January 1, 2007. Actual consolidation then must be complete by January 1, 2007. If enacted, this bill would be effective January 1, 2006, and it may be difficult for BOE to submit the requisite report for consolidating the four departments by the June 30, 2006, deadline.

Pursuant to AB 986 (Horton, Stats. 2003, Ch. 569), the Legislative Analyst recently issued a report to the Legislature regarding the merits of consolidating specific functions and operations of FTB, BOE, and EDD. Legislative Analyst Office (LAO) summarizes the findings of its report released January 10, 2005, as follows:

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<sup>2</sup> This includes 142.8 positions and nearly \$237 million for the CCSAS Project.

<sup>3</sup> This includes support functions that are located in areas other than the Tax Branch, including administrative, legal and technology positions.

Consolidation of the tax agencies' payment and documentation processing activities could in the medium to long term generate some annual cost savings and interest earnings through elimination of duplicative functions and increased efficiencies. The state, however, would have to incur significant net costs in the short term to achieve these savings. In addition, such benefits are likely to be less than benefits from increasing electronic processing. We therefore recommend that low priority be given to consolidation of payment and document processing functions in favor of steps to increase electronic processing.

LAO further noted that expanding electronic technologies could be used to achieve "virtual consolidation" of remittance and document processing. The report states, "Under this type of system, taxpayers could log onto a single Web site and through a series of menus, be directed to the proper form which would allow them to file their taxes or remit a payment. This payment, in turn, would be automatically directed to the appropriate agency."

## **LEGISLATIVE HISTORY**

Appendix A contains a comprehensive listing of legislation regarding the consolidation or transfer of duties of state tax agencies. Notable legislation is listed below.

SB 216 (Dutton, 2005/2006), which is identical to this bill, would abolish FTB and transfer its duties and powers to BOE as of January 1, 2007. This bill is currently with the Senate Government Modernization, Efficiency and Accountability Committee.

SCA 9 (Ducheny, 2005/2006) would change the name of the BOE to the California Tax Commission and provide for nine voting members. The measure would require the commission to collect and administer taxes on or measured by income and taxes withheld from wages, and to conduct administrative review of tax determinations. This measure, which is substantially the same as ACA 14 (DeVore, 2005/2006), is currently with the Senate Revenue and Taxation Committee.

ACA 14 (DeVore, 2005/2006) would change the name of the BOE to the California Tax Commission and provide for nine voting members. The measure would require the commission to collect and administer taxes on or measured by income, and to conduct administrative review of tax determinations. This measure, which is substantially the same as SCA 9 (Ducheny, 2005/2006), is currently at the Assembly Desk.

SB 1424 (Burton, 2003/2004) and AB 2472 (Wolk, 2003/2004) would have transferred from the BOE responsibility for hearing and deciding franchise and income tax appeals to a newly created California Tax Court. Both bills were held in first house committees.

AB 2000 (Dutton, 2003/2004) would have abolished the FTB and transferred its duties and powers to BOE. This bill was held in the Assembly Revenue and Taxation Committee.

ACA 22 (Dutra, 2003/2004) and ACA 13 (Leonard, 2001/2002) would have changed the name of the five-member BOE to the California Tax Commission and required it to collect and administer "taxes on or measured by income." Both measures were held in first house committees.

AB 15 (Klehs, et al.; 1993/1994) would have abolished the FTB and transferred its duties and powers to BOE. Governor Wilson vetoed AB 15 stating his concern with the centralization "of all state policy, implementation and administration outside the executive branch of government." He also noted that there was an inherent conflict of interest for "the [BOE] to serve as both administrator of the tax system, as well as the appellate body for taxpayer appeals."

## **OTHER STATES' INFORMATION**

Most other states have a department under the governor, commonly named the Department of Revenue, which administers most types of taxes. Utah, Idaho, Mississippi, and Oklahoma have tax commissions, with all or a majority of the members of the commission appointed by the governor. North Dakota, Maryland, and Texas have an elected commissioner or comptroller who oversees tax administration. A majority of states have independent bodies such as tax courts or tribunals that adjudicate tax appeals.

## **FISCAL IMPACT**

Consolidating FTB with BOE provides opportunities to increase efficiency and effectiveness over the long term; however, the magnitude of impact is unknown and would be realized over time. Potential benefits would be offset by the costs associated with merging the organizations and their systems, particularly in the short-term. The magnitude of the benefits and costs will depend on the degree to which the departments' functions and systems are integrated as a result of consolidation. In addition, working through the organizational, technology, and other issues associated with merging FTB, EDD, and Department of Insurance into BOE could divert resources from core revenue-generating functions and the CCSAS Project, which must be successfully implemented to relieve the state of over \$200 million in federal penalties annually.

An accurate cost analysis of consolidation would require input from the other affected departments to analyze each function and process the department performs in comparison to functions and processes performed by BOE. Accordingly, the department's costs to administer this bill cannot be determined at this time. The department will continue to analyze consolidation and its potential fiscal impacts as this bill moves through the legislative process.

## **ECONOMIC IMPACT**

For the fiscal year 2003-04, FTB's programs contributed \$43.3 billion to the General Fund. This contribution represented 57.9% of General Fund revenues, which totaled \$74.8 billion. The timing of tax revenue receipts as well as disbursements to taxpayers would be impacted to the extent implementation of this bill disrupts FTB's existing programs.

## **ARGUMENTS/POLICY CONCERNS**

### Pros

- Because the organizations have some similar functions, there could be opportunities to improve efficiencies in those areas, e.g., audit, collections, and administrative functions, such as personnel, procurement, accounting, budgeting, communication services, and other support function.
- While FTB, EDD, and BOE currently share some information among their programs, bringing the IT systems and data under one organization would provide opportunities for improving tax enforcement and customer service functions through better use of information. It could also alleviate some concerns raised by the IRS associated with sharing of IRS information across separate state entities.

- Each organization proposed for consolidation has experienced success in certain areas that could be leveraged by the programs of the other organizations. For example, it might be possible to expand FTB's Accounts Receivable Collection System and Integrated Nonfiler Compliance System to improve compliance in other tax programs.
- A consolidated department would offer taxpayers and their representatives a single point of contact for filing of returns, payment transactions, inquiries for assistance, and other customer services.
- A consolidated department could further consolidate field office public service operations of the FTB, EDD, and BOE.

### Cons

- BOE would be the administrator, auditor, and deciding body for taxpayer disputes of its actions. As a result, taxpayers could argue that they are being deprived of a pre-payment appeal to an independent administrative or judicial body. In most states and at the federal level, tax administration and tax adjudication functions are performed by independent bodies.
- Abolishing FTB would remove the Administration and its Department of Finance from direct oversight of the administration of most state taxes. The majority of the state's revenue-generating functions would be under the direction and control of constitutionally elected officials. If this change were made, taxpayers would likely still view the governor as accountable for tax administration despite the fact that the governor would have no direct involvement. In all but three other states, the governor has direct involvement in tax administration. At the federal level, the president is similarly involved in tax administration. Centralization of tax administration outside the executive branch was the primary reason cited by former Governor Wilson for his veto of AB 15 (Klehs, et. al., 1993/94).
- FTB, BOE, and EDD are each larger than most state revenue departments. The enormity of a consolidated department might itself increase the complexities of the administrative structure by adding more decision-making levels.
- Implementing a consolidation effort on the scale contemplated by this bill could, as a result of redirection of limited resources during the transition period, distract from the department's core revenue-generating programs and the CCSAS Project, which must be successfully implemented to relieve the state of over \$200 million in federal penalties annually.
- While consolidation would allow for unified administration for the tax agencies, the functional structure might not be much different than the current tax-by-tax structure. Since the four departments administer different taxes under distinctly different tax and compliance laws, it is unclear if there would be any economies of scale in combining similar staff functions. For example a consolidated audit division still may require specialization among auditors because: 1) the degree of complexity varies among the tax laws; 2) the tax calendars for income and sales and use taxes are generally different; and 3) the auditing requirements for one tax differ greatly from the other. A preliminary review of the organizational structure of other states indicate that within a general Department of Revenue some states<sup>4</sup> administer taxes as separate offices, divisions, or bureaus. This bill may result in an organizational structure similar to states with a common administrative oversight instead of full integration of the agencies.

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<sup>4</sup> Indiana, Kansas, Louisiana, Missouri, New York, and South Carolina.

- In its January 10, 2005, report on the merits of consolidating specific functions and operations of FTB, BOE, and EDD, LAO recommends that priority should be given to taking steps to increase electronic processing rather than consolidate payment and document processing functions because of the higher anticipated benefits of the former. LAO's findings are summarized above in "Implementation Considerations."
- There would be some costs associated with bringing the organizations together. The degree to which the departments are integrated will drive costs associated with integration, e.g., moving staff, training, and systems changes.

## **LEGISLATIVE STAFF CONTACT**

Anne Mazur  
Franchise Tax Board  
845-5404  
[anne.mazur@ftb.ca.gov](mailto:anne.mazur@ftb.ca.gov)

Brian Putler  
Franchise Tax Board  
845-6333  
[brian.putler@ftb.ca.gov](mailto:brian.putler@ftb.ca.gov)

## Appendix A Legislative History

Bill Number	Action	Status
AB 1615 (Klehs, 2005/06)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Assembly Desk
SB 216 (Dutton, 2005/06)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Senate Government Modernization, Efficiency and Accountability
SCA 9 (Ducheny, 2005/06)	Create a California Tax Commission and provide for 9 voting members. Continue BOE Duties as well as administer income taxes.	Senate Revenue and Taxation
ACA 14 (DeVore, 2005/06)	Create a California Tax Commission and provide for 9 voting members. Continue BOE Duties as well as administer income taxes.	Assembly Desk
ACA 22 (Dutra, 2003/04)	Create a California Tax Commission/Continue BOE Duties As Well As Administer Income Taxes	Failed passage from Assembly Revenue and Taxation
AB 2000 (Dutton, 2003/04)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Failed passage from AR&T
SB 1424 (Burton, 2003/04)	Replace BOE hearing functions with Tax Court.	Failed passage from Senate Revenue and Taxation
AB 2472 (Wolk, 2003/04)	Replace BOE hearing functions with Tax Court.	Failed passage from Asm. Appropriations
ACA 13 (Leonard, 2001/02)	Create a California Tax Commission/Continue BOE Duties As Well As Administer Income Taxes	Failed passage from Asm. Appropriations
AB 2794 (Bowen, 1995/96)	Abolish FTB/Create Department of Revenue/Create Board of Tax Appeals	Failed passage from AR&T
SB 1727/SCA 29 (Kopp, 1995/96)	Abolish FTB and BOE/Create State Taxing Authority/Create Board of Tax Appeals	Failed passage from Asm. Appropriations
AB 15 (Klehs, 1993/94)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Vetoed
AB 1026 (Peace, 1993/94)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Amended to no longer impact FTB
AB 2267 (Andal, 1993/94)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Failed to pass out of Assembly by deadline
SB 87/SCA 5 (Kopp, 1993/94)	Abolish FTB and BOE/Create Department of Revenue/Create Board of Tax Appeals	Failed passage. Sen. Kopp requested inactive file
SB 1829 (Campbell, 1993/94)	Abolish FTB/Create Department of Revenue	Failed passage from SR&T
SB 2137 (Campbell/Kopp, 1993/94)	Abolish FTB/Create Department of Revenue/Create Board of Tax Appeals	Failed passage from Sen. Appropriations